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July 11. 2004

Via Electronic Mail

Board of Governors of the Federal Reserve Systcni
20th Street and Constitution Avenue. N.W.
Washington, D.C. 20551

Attention: Jennifer J. Johnson, Secretary

Re: Notice of Proposed Rulemaking on Trust Preferred Securities and Definition of Capital – Docket No. R-1193

Ladies and Gentlemen:

Citigroup Inc. (hereinafter "Citigroup") welcomes the opportunity to comment on the notice of proposed rulemaking (hereinafter "NPR" or "proposal") recently issued by the Board of Governors of the Federal Reserve System (hereinafter the "Board") regarding regulatory capital matters principally the nature and extent of trust preferred securities (hereinafter, occasionally referred to as "TRUPS®") deemed permissible as tier 1 capital elements.

We applaud the Board for its ongoing recognition of the importance of TRUPS as a viable means for U.S. bank holding companies (hereinafter, occasionally referred to as "BHCs") to raise tax-efficient financing, the terms of which reflect the effective core capital nature of the arrangement. and whose related risk-based capital treatment should not therefore be compromised by a change in financial accounting (such as FIN 46R). Furthermore, we note that by continuing to allow the inclusion of trust preferred securities in the tier 1 capital of bank holding companies. the Board is broadly acknowledging the competitive need for these types of relatively simple and well understood instruments in the global marketplace.

While Citigroup is of the opinion that certain aspects of the Board's proposal regarding the imposition of a quantitative limit on the extent of trust preferred

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securities and other restricted core capital elements includable within the tier 1 capital of bank holding companies are unduly onerous. as well as discriminatory to large U.S. bank holding companies (i.e., those deemed "internationally active" or expected to be subject to the advanced internal ratings based approach under Basel II) relative to both certain domestic and foreign competitors. it is the implied restrictiveness of the proposal vis-à-vis the lack of tier 1 capital eligibility for similar TRUPS-like subordinated debt instruments (either directly issued by bank holding companies or indirectly issued by certain overseas banking subsidiaries) that we find unjust and most distressing.

Set forth below are our specific comments on these and other matters.

1. Other Tier 1 Capital Instruments

A. Like Subordinated Debt

Citigroup strongly believes that deeply subordinated debt issuances of U.S. bank holding companies that otherwise satisfy the conditions normally imposed on qualifying trust preferred securities structures. other than having a trust interposed as the issuing vehicle for a legal-form equity instrument. should also be eligible as qualifying tier 1 capital elements. These debt issuances are the substantial equivalent of permanent common equity, and can provide the same degree of loss absorption and liquidity protection as qualifying trust preferred securities. Moreover, in certain OECD countries. banking organizations' direct issuances of such debt instruments are eligible for tier 1 capital treatment. and thus U.S. BHCs are presently operating at a significant competitive disadvantage to their foreign counterparts by not being able to include these types of instruments in qualifying tier 1 capital.

This position is further supported by the fact that under current U.S. GAAP (i.e., FIN 46R), the trust in TRUPS offerings is generally no longer consolidated with the issuing bank holding company, such that the consolidated balance sheet of the bank holding company simply reflects the underlying subordinated debt (a liability) issued to a third party trust rather than a preferred equity position effectively functioning as minority interest, as in the past. The "wrapping" of the subordinated debt in a trust never altered the economics or substance of the transaction for either the issuing bank holding company or the investors. as the trust functions merely as a pass-through vehicle. Bank holding companies and investors fully understand that the economics of these transactions derive from the underlying subordinated debt. Accordingly, it is not reasonable to require bank holding companies to incur the cost of inserting a trust in between the investors and the underlying subordinated debt. and to likewise not permit direct issuances by bank holding companies of deeply subordinated debt that meets all other requirements of trust preferred securities from also qualifying as a permissible tier 1 capital element.

Additionally. many foreign banks (particularly those in OECD countries) have issued capital instruments that qualify as tier 1 capital under local regulatory requirements and the Basel Committee on Banking Supervision's (hereinafter.

occasionally referred to as "the Committee") October 1998 interpretation on innovative capital instruments. Like traditional trust preferred securities, these capital instruments provide the issuing bank with the ability to absorb losses both on an ongoing basis and in liquidation, given that the securities rank junior to the bank's other liabilities and afford the issuer the ability to defer payments.

U.S. banking organizations with foreign bank operating subsidiaries that are subject to local capital adequacy requirements may satisfy those local requirements by issuing trust preferred securities at the level of the U.S. bank holding company and then injecting the proceeds as capital into the foreign subsidiary. As an alternative, however, it may be more efficient for certain institutions to satisfy their local capital adequacy requirements by issuing capita1 securities directly at the level of the foreign subsidiary. This might be the case for a U.S. banking organization with a foreign subsidiary that enjoys high name recognition in its local capital markets and is consequently able to fund in local currency or at lower rates than its U.S. parent.

Accordingly. Citigroup strongly recommends that the Board consider allowing innovative capital instruments issued directly by a foreign banking subsidiary of a U.S. bank holding company that qualify as tier 1 capital at the subsidiary level under the local regulatory capital regime and satisfy the requirements of the Committee, to also fully qualify as permissible tier 1 capital at the consolidated U.S. bank holding company level.

B. Moderate Rate Step-ups

The WPR proposes to expressly include in the risk-based capital guidelines the Board's long-standing view that a coupon step-up. however moderate, generally disqualifies the instrument froin inclusion in tier 1 capital. Citigroup opposes that view and strongly urges the Board to revisit this preliminary conclusion by permitting moderate step-ups that satisfy the criteria in the Basel Committee on Banking Supervision's aforementioned October 1998 interpretation.[1] It is believed that these types of step-ups are sufficiently moderate so as to preclude an economic compulsion to redeem the trust preferred securities. Further. **the** pricing benefit from permitting moderate step-ups of this type, and the related reduction in cost of capital can be significant. This is especially true during periods of liquidity crises in the fixed income capital markets (e.g., the 1998 Asian currency devaluations. Russian sovereign default on its short-term obligations. and collapse of Long-Term Capital .Management), wherein the prevailing cost of refinancing a position could exceed any permitted moderate step-up and thereby adversely affect a banking organization's tier 1 capital. Finally. the

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[1] This interpretation permits a step-up in conjunction with a call option only if the step-up occurs at least ten years after the issue date and if it results in an increase over the initial rate that is no greater than either: (1) 100 basis points. less the swap spread between the initial index basis and the stepped-tip index basis, or (2) 50% of the initial credit spread. less the swap spread between the initial index basis and the stepped-up index basis.

requirement for prior Board approval would also act as an important safeguard over the early redemption of any TRUPS containing a moderate step-up provision.

It should also be noted that many national bank regulators in Europe. the Asia Pacific region, Latin America. and Canada have adopted the position taken by the Committee regarding moderate step-ups in innovative tier I capital instruments. Consequently, banking organizations in those jurisdictions are able to access the institutional tier 1 fixed income capital markets in a more cost effective manner than would have been possible otherwise. Citigroup believes that U.S. bank holding companies should likewise be allowed to benefit from the ability to issue tier 1 qualifying TRUPS that include moderate step-ups, because to do otherwise would place these banking organizations at a competitive disadvantage relative to a large number of other institutions based in jurisdictions other than the U.S.

C. REIT Preferreds and Mandatory Convertibles

We request that the Board consider allowing certain instruments in tier 1 capital up to a limit of 25% of tier 1 capital despite the fact that such structures employ non-bank subsidiaries. such as perpetual. non-cumulative REIT preferred securities and securities that must be converted into common shares (with appropriate limits on dilution) within a three-year period. Citigroup believes that REIT preferred securities, for instance. may be structured to provide a BHC with the same flexibility to absorb losses as perpetual preferred stock issued directly by the BHC. and as such should be treated as class B minority interest when determining regulatory capital limitations.

2. Quantitative Limits – TRUPS and Other "Restricted Core Capital Elements"

The proposal imposes limits on the aggregate amount of "restricted core capital elements" which may be included in the tier 1 capital of bank holding companies, with "'internationally active" bank holding companies limited to 15% of the sum of core capital elements (including "restricted core capital elements") net of goodwill and all other bank holding companies subject to a 25% threshold. Moreover, this concept of "restricted core capital elements" has been defined to encompass not only qualifying trust prcfcrred securities and cumulative perpetual preferred stock but also certain types of minority interests. Currently, there is no distinction made between so-called "internationally active" bank holding companies and all other U.S. bank holding companies, and the extent to which qualifying trust prcfcrrcd securities and cumulative perpetual preferred stock is includable in tier I capital is limited to 25% of the sum of core capital elements without a deduction for goodwill. Accordingly, the interplay of the proposed reduced limit on trust preferred securities and other "restricted core capital elements?', coupled with a goodwill deduction against the base upon which such limit is applied, would establish a significant constraint on the ability of many U.S. banking organizations to raise tier 1 capital effectively and competitively .

While Citigroup could accept a reduced limit of 15% for the amount of "restricted core capital elements" includable in tier 1 capital, we submit that this would only be palatable on the basis that goodwill not also be deducted in computing the base upon which the 15% would be applied. We therefore strongly urge the Board to reconsider the treatment of goodwill, and to impose a limit on "restricted core capital elements" prior to the subtraction of goodwill.

A. Goodwill Deduction

In July of 2001, the FASB issued Statement No. 141, *Business Combinations*, and Statement No. 142, *Goodwill and Other Intangible Assets*. Taken together, these standards generally require that all business combinations initiated after June 30,2001 be accounted for under the purchase method of accounting, and that goodwill no longer be amortized against earnings but instead be reviewed periodically for impairment. Consequently, these financial accounting requirements serve to dispel the longstanding notion that goodwill is an asset lacking in value, and we therefore believe that it is inappropriate to require that goodwill be deducted from the sum of core capital elements. Additionally. one argument that has been traditionally offered for the total discounting of goodwill relates to its supposed lack of value in an insolvency. Citigroup believes that view is incorrect. Banks that are in serious financial difficulty are often sold before a receivership occurs. Even after receivership, bank deposits can normally be sold at a premium: accordingly. there is some value to the banking franchise attributable to the value that may be realized from the deposit relationships.

While we believe these points to bc compelling, should the Board nevertheless require that goodwill be subtracted from the base of core capital elements against which the percentage limit on restricted core capital elements is applied. we believe that any deduction of goodwill for this purpose should be on a "net of tax" basis. Such an approach would recognize the absolute minimum economic value of goodwill, as well as be consistent with regulatory precedent for similar situations, In this regard. we refer you to a letter from The Clearing House dated April 1 1, 2002 in which there is discussion of the rationale as to why goodwill should not be deducted from the sum of core capital elements, but if deducted. should be on a "net-of-tax" basis (reference pages 4 and 5 of that letter).

B. "Internationally Active Banking Organizations"

Citigroup is of the view that a distinction should not be drawn between "internationally active banking organizations" (regardless of how defined) and other U.S. banking organizations, for purposes of applying a limit on the amount of qualifying trust preferred securities and other restricted core capital elements which may be includable in tier 1 capital. Rather, there should be an across the board standard relative to all U.S. banking organizations, except perhaps for those smaller community banks which have limited access to the capital markets. Otherwise, a number of large and very competitive U.S. banking organizations will not fall within any likely definition of "internationally active". and would consequently benefit from such a distinction. We can foresee no

reason to afford such organizations greater access to tax-advantaged capital instruments or other restricted core capital elements. Doing so would put banking organizations deemed to be internationally active at a major competitive disadvantage to some other relatively comparable U.S. institutions.

If, however. the Board were to retain a distinction between "internationally active" BHCs arid all other BHCs when setting capacity limitations on class B and class C minority interests (as well as all other restricted core capital elements). we request that the Board provide a rnore explicit definition of the term "internationally active banking organization".

C. Phase-in Period

The NPR proposes that the quantitative limits on restricted core capital elements be phased-in over a three-year transition period. becoming fully effective as of March 31. 2007.

Citigroup strongly urges the Board to reconsider its position and adopt a five-year instead of a three-year transition period, given that a significant volume of bank holding company TRUPS have been issued since July 1, 2002 with "no-call" periods of at least five years (meaning the no-call periods expire at various dates after July 1, 2007). **A** five-year transition period would therefore allow affected bank holding companies substantially more flexibility in managing their compliance with the new standards through a combination of the redemption of trust preferred securities whose no-call periods have expired and internal capital generation.

3. Qualitative Standards - TRUPS

A. Issuer Call Option

The Board's NPR proposes that qualifying TRUPS be redeemable at the option of the issuer no later than ten years from the issuance date. In the past. the Board has approved as tier 1 capital trust preferred securities with call options that allow the issuer the right to redeem the securities at: (1) par value. *(2)* a premium to par value, or (3) the greater of par value or a make-whole amount (where the make-whole amount represents the present value of all remaining principal and interest payments discounted at a rate equivalent to a pre-specified spread over the then- prevailing applicable US treasury yield).

Depending upon market conditions and its financing objectives, a U.S. BHC may have a preference as to which of the three types of call options it wishes to incorporate into a given trust preferred securities offering. In order to maximize the future financing flexibility of U.S. BHCs while complying with the Board's proposal that trust preferred securities be redeemable at the option of the issuer no later than ten years from the issuance date, we strongly recommend that the Board explicitly allow U.S.

BHCs to include either a par call, a premium call. or a make-whole call in future issuances of trust preferred securities.

B. Deferral Notification Period

The proposal indicates that any notification period for a deferral of payments on trust preferred securities by the issuer must be reasonably short, generally no more than one business week, We seek clarification as to whether such notification requirement applies to the period prior to the record date or prior to the scheduled payment date.

It is general market practice for issuers of securities that provide for the deferral or suspension of periodic payments to notify holders of a pending deferral or suspension prior to the record date. Citigroup believes that it would be difficult for certain BHCs, particularly smaller. community BHCs, to make payments on trust preferred securities in a timely manner if it were mandatory that the record date occur within four business days of the payment date. We therefore strongly suggest that the notification requirement apply to the period preceding the record date. which generally occurs between one business day and fifteen business days prior to the scheduled payment date.

C. Subordination Requirements

The NPR requires that qualifying TRUPS meet certain requirements with respect to subordination (e.g., one such requirement is that the underlying subordinated note issued by the BHC be subordinated to all other subordinated debt of the BHC). Citigroup requests that the Board allow BHCs to include a provision in qualifying TRUPS that permits BHCs to issue debt in the future that ranks either junior to, or on par with. the underlying subordinated note in a qualifying TRUPS offering, provided that such indebtedness be approved as regulatory capital prior to issuance by the Board or relevant district Federal Reserve Bank.

4. Regulatory Reporting Treatment – TRUPS

Bank holding companies currently report the underlying subordinated debt in trust preferred securities offerings as "other liabilities" on Schedule HC of Form FR-Y9C. Citigroup believes that it would be more appropriate and consistent with the current U.S. GAAP balance sheet presentation required by FIN 46R, to classify this item as "subordinated debt"". If the intent is not to commingle the underlying subordinated debt in trust preferred securities transactions with all other subordinated debt, then we strongly urge the Board to create a separate line item in Schedule HC for the subordinated debt issued to trusts in these transactions. This will not only facilitate reconciliation of total subordinated debt disclosed in public financial statements to the amounts disclosed in regulatory reports. but also lead to greater transparency.

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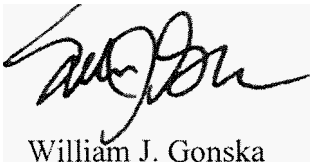
Thanking you in advance for your consideration of the views expressed herein. We would welcome the opportunity to meet with you in person: should that be desirable. Alternatively. if you have any questions. please contact me at (212) 559-4883.

Sincerely.



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